



Ohio Consumers' Counsel

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Consumers' Counsel

May 21, 1997

The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Bldg.
U.S. House of Representatives
Washington, DC 20515

Dear Representative Dingell:

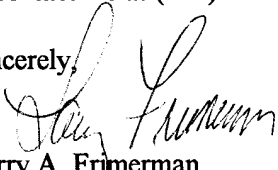
Enclosed are the responses of the Ohio Consumers' Counsel to your thoughtful and insightful questions in your letter dated April 16, 1997.

As you may know, Ohio is not among states that have begun to implement retail electric generation competition. It is not a coincidence that the states who have moved most quickly toward greater retail competition are states like California and New Hampshire with high electricity rates that are due in large part to high cost nuclear power plants. It remains to be seen whether these efforts to bring rates down through competition will succeed, but we can certainly recognize the concerns of consumers in low cost states who may see little advantage and great potential harm by moving too quickly to a competitive model. Even worse, some federal legislative proposals would undermine competitive efforts in high cost states, because the federal competition mandate would be coupled with the requirement that utilities must be fully reimbursed for all costs that are "stranded" due to retail competition. Americans should not be forced to participate in a grand national retail competition experiment by a near term date certain, while at the same time preventing most consumers from seeing any benefit from such competition for a decade or more because of a federal requirement that ratepayers must make their utilities whole for every penny of uneconomic investments that they could not recover in a truly competitive market.

The Ohio Consumers' Counsel has not taken a position either at the state or federal level that flatly prohibits any recovery of retail stranded costs. Instead, we think that each state must determine what the just and reasonable level of recovery should be in light of that state's historic allocation of utility generation risks and costs.

Our office would appreciate the opportunity to discuss these issues further with you or Ms. Sheridan at any time of your convenience. Also, if we be of assistance to you as this debate continues, please do not hesitate to contact me at (614) 466-9557.

Sincerely,


Larry A. Frimmerman
Federal Liaison

cc: Sue Sheridan

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**John D. Dingell, Ranking Member
Commerce Committee Democratic Office**

1. How has the increased competition in wholesale electric markets affected consumers in your State to date?

Answer: It is difficult to measure the effects of wholesale competition on retail consumers. Consumers have received some benefit to date because reductions in wholesale energy costs generally have been flowed through to retail consumers through Ohio's Electric Fuel Component rates. However, even if lower cost wholesale power is available to utilities, retail ratepayers continue to pay for their own utilities' high capital cost power plants in base rates. As long as the utility has a franchised monopoly over its retail generation customers, it can continue to charge the full capital costs of its own power plants to ratepayers, even while the utility is purchasing lower cost power on the wholesale market.

2. What role has your office played in any state proceedings on retail competition? What position has your office taken on the issue of whether or not retail competition would benefit consumers and on the issue of whether or not federal legislation mandating adoption of retail competition by a date certain, or any other type of federal legislation, is needed? Do you believe there are substantial differences among the various states' consumer advocates, and why or why not?

Answer: Our office has been very active in every aspect of the restructuring debate in Ohio both at the legislature and before the Public Utilities Commission of Ohio. The attached OCC Governing Board principles identify criteria necessary for consumers in Ohio to benefit from generation competition. However, we remain skeptical that such conditions will be met. Some consumers may not benefit from a transition to competition if certain conditions are not met. However, we would oppose federal legislation that mandates retail competition nationwide by a date certain. Ohio's General Assembly, regulatory agencies and stakeholders are in the best position to determine if, when, and under what conditions should retail competition occur in Ohio. There are differences among states regarding the relative risks and benefits of retail generation competition. Some high cost states such as California may seek to employ retail competition as a way of reducing rates for generation that could only be imposed by a monopoly on captive customers. Other states, particularly those with lower rates, may see little benefit from a near term transition to retail competition. Different states may also have different needs with respect to the impact of retail competition on residential and low income consumers as well as potential environmental concerns.

3. Some proponents of federal legislation mandating that states adopt retail competition by a date certain argue that substantial numbers of large industrial customers recently have negotiated favorable rates with their public utility commissions. Such proponents have further argued that residential and small commercial consumers lack bargaining power to achieve similar rate reductions. Finally, these proponents argue that federal legislation is essential to ensure that smaller consumers are not economically disadvantaged relative to large industrial customers.
- a. Please indicate whether or not you agree with the three premises outlined above.
 - b. In particular, please indicate whether you have reason to believe that large industrial customers are being favored in rate negotiations before public utility commissions relative to smaller commercial and residential customers. What type of state statutory direction generally governs such rate determinations? Historically, how have states balanced the interests of different customer classes? Is this changing?
 - c. What position has your office taken in recent rate proceedings concerning large industrial customers' requests for rate reductions?
 - d. In general, have consumer electricity prices in your State been rising, holding steady, or falling, and why?

Answer: Industrial customers have long exercised the ability to force special rates because of their ability to threaten to shift production or to move their facilities to other states. New industrial customers can gain rate discounts as part of an economic development package of incentives offered to encourage them to move into the state. Although individual residential and small business customers currently may lack the same type of bargaining power, this in and of itself is not a sufficient argument in favor of a federal mandate. Instead, this is an aspect of the balancing of interests that each state must undertake as part of its deliberations regarding when and how to move to retail competition.

Large industrial customers in recent years have been able to receive favorable treatment in rate proceedings and through special negotiations with utilities because of the economic development impact that those customers have. Ohio law permits these types of rates as long as they cover incremental costs, some contribution to fixed costs and are not "unduly discriminatory." Ohio has given deference to the economic development needs of large industrial customers in recent years.

OCC was not successful in preventing these rates from going into effect. We have since focused on trying to prevent utilities from shifting the costs of industrial discounts onto small consumers. In Ohio, utilities are not compensated for competitive response contracts (where a customer threatens to abandon service in favor of another provider such as a municipal power agency), but may recover half of their lost revenues from base rates for economic development contracts.

In general, electric rates rose rapidly in the 1970's and 1980's. However rates have leveled and even have declined in some cases in the 1990's after our utilities completed their large construction programs that produced many of the earlier rate increases. Centerior Energy was granted a rate increase by the Public Utilities Commission of Ohio in 1995. However, OCC has recently reached stipulations with Ohio Edison and Centerior Energy for rate reductions to continue midway through the next decade. In fact, the Centerior agreement was a part of a comprehensive merger settlement which will provide almost \$500 million in savings to ratepayers and a sizable write down of overvalued nuclear assets.

4. What are the most difficult issues to resolve in connection with utilities' stranded costs? To the extent your State has adopted, or is consider adopting, retail competition, has there been an attempt to distinguish between costs which were prudently incurred and those which were not? If Congress were to enact legislation mandating that states adopt retail competition by a date certain, what, if any, provisions relating to stranded costs should be included? Is securitization a useful tool, and how would it affect different interests?

Answer: In Ohio, the General Assembly and the stakeholders may have to determine a just and reasonable sharing of stranded costs. This requires a balancing of the interests and expectations of investors and consumers. The question is not whether the costs were prudently incurred. If the costs had been imprudent, they should not have been included in rates in the first place and therefore would not be stranded by competition. The question is whether ostensibly prudent investments that are rendered non-used and useful by competition should nevertheless continue to be charged in full to consumers.

In Ohio, it has long been held that utilities are not guaranteed recovery of a full and a return on non-used and useful investments (including uneconomic excess capacity), even if those costs were prudently incurred. In a United States Supreme Court case, Duquesne Light Company v. Barasch, the Court rejected the utilities' challenge to a used and useful statute similar to Ohio's even though the application of that statute resulted in the total disallowance of over \$40 million of prudently incurred costs on four cancelled nuclear power plants.

Congress should not attempt to address the treatment of retail stranded costs, other than possibly to require that each state conduct some regulatory or legislative proceeding to address the issue. Congress is not likely to develop a single stranded cost rule that would fairly treat both utilities and ratepayers in all 50 states. Treatment of stranded costs which were incurred under specific regulatory regimes for retail customers under state jurisdiction in one state, given that state's historic allocation of risks and costs, might be inappropriate for either utilities or ratepayers in another state.

Securitization might reduce the total cost of stranded cost recovery. However, there are significant risks associated with securitization, and many industry watchers are now seriously questioning the efficacy of using securitization. If securitization is approved by a state legislature, there must first be a determination that the costs involved will certainly be stranded, and a determination that it is just and reasonable to impose those costs on ratepayers. Securitization

involves an irrevocable order which locks in recovery of the revenue stream for the life of the securitized bond. Securitization might reduce the charges on stranded costs because the interest rate on the securitized bond could be lower than the utility's overall cost of capital. But, ratepayers only benefit if it is completely certain that these costs would have been recovered anyway from ratepayers at the higher capital cost. Securitization has other results. It also could allow the receiving utility to have a significant cash infusion which could be used to underwrite nonutility investments. In addition, the guaranteed revenue stream implicit with securitization may unfairly strengthen the financial picture of the utility in question beyond that of utilities without stranded costs.

5. Some proponents of retail competition hold the view that all electricity resources should be sold at market prices and that state authority to regulate retail rates should be eliminated. Could such a policy result in rate increases for customers that currently receive the benefit of such low-cost resources? In a restructured electric utility industry, who should receive the benefits of these low-cost resources--utility ratepayers, utility shareholders, or simply the highest bidder?

Answer: In the future, the market may be more efficient than regulation in establishing the price of retail electric generation. This answer only applies to electric generation, not distribution, which remains a natural monopoly that should continue to be price regulated. However, there is a possibility that rates in low cost areas would rise to a "regional average" in a competitive market. Certainly, if stranded costs are permitted to be recovered, the market price during the recovery period will be distorted in affected regions. Therefore, it is possible that rates may not drop sufficiently even after the transition if we no longer have the excess capacity situation which we currently experience. In the Midwest, many believe that there will be a need for additional capacity around 2005, approximately the same year that full retail competition may begin in earnest. The impact of such an occurrence may be to drive rates up, not down.

In addition, the question of how to allocate the benefits of low cost existing resources is the flip side of the stranded cost issue on high cost resources. This is a transitional issue which should be decided on a state by state basis.

States should not follow the lead of the FERC in Order 888. FERC's policy may permit low cost producers to sell at market-based rates, while high-cost producers will charge the sum of market price plus stranded costs. Since market price plus stranded costs equals the current high embedded cost, that means that FERC policy could permit utilities to sell at the higher of cost or market. This also means that consumers can never benefit from competition as long as stranded costs are being recovered. This is because customers of low cost utilities will pay the market price (even if that price is higher than the utility's actual cost), while customers of high cost utilities will pay market price plus stranded costs.

6. Recently there has been increased discussion of the need for Congress to enact "reciprocity" requirements barring retail sales of power by parties located in states which

have not adopted retail competition to parties in states which have adopted retail competition.

- a. Do you have a position on this issue?
- b. Which interests would benefit from a federal reciprocity requirement, which would not, and why?

Answer: Such a requirement could harm Ohio consumers by limiting customer choice. A federal reciprocity rule would protect utilities from competition from utilities in other states that did not yet allow retail competition, but such a requirement may not benefit consumers in either state.

7. Does your State currently have adequate tools to protect the interests of low-income electricity consumers if Congress were to mandate retail competition by a date certain? If such legislation were enacted, do you have any recommendations as to how Congress should approach this important issue?

Answer: The Ohio General Assembly has the authority to pass a statute which could permit low income programs to continue in Ohio. Since we are opposed to a federal retail competition mandate, OCC does not believe this issue needs to be addressed at the federal level. If there were a federal retail competition mandate, however, we would support a provision which would require utilities to specifically address low income issues as part of their restructuring plans.

8. Do you have any concerns about reliability of service or the ability of the interstate transmission or local distribution systems to handle the transactions that would occur if retail competition became more prevalent?

Answer: Reliability concerns can be addressed adequately from a technical standpoint. It is more difficult to determine how to reconcile the need for reliability with the need to keep the ownership and control of the transmission and distribution systems from being used as a means of thwarting generation competition. The efforts to establish an Independent System Operator in the Midwest ISO as well as the Pennsylvania-New Jersey-Maryland (PJM) Interconnection have thus far been filled with problems. These issues must be resolved in a way that reliability is preserved but full and fair competition is permitted.

9. Are rural and urban consumers in different positions with respect to their relative ability to bargain for competitive electricity prices? Are all consumers similarly situated in terms of aggregation?

Answer: In contrast to the telephone industry, where rural customers may be in some jeopardy, rural and urban electricity customers are in relatively equal positions with respect to electricity generation. This is because electricity competition is to occur at the generation level, while the distribution system will remain regulated. There is no reason rural customers should not be able to have comparable access to competitive generation, as long as the distribution systems that serve them are not subject to competition. It may be easier to aggregate customers in

concentrated urban areas, and thus reduce transaction costs per customer. But generally, the cost of providing electric generation service in rural areas should not be much different than in urban areas.

10. Some proponents of retail competition have argued in favor of federal legislation requiring states to adopt retail competition regimes which include mandatory unbundling of those services currently provided by local distribution companies. What advantages and disadvantages might this pose for consumers? Do you have any recommendations?

Answer: Unbundling is necessary as part of any restructuring effort. At a minimum, generation service must be unbundled from other services, so that generation can be provided on a competitive basis. OCC has not yet determined whether further unbundling of services such as metering and billing should be implemented or it would be preferable to go forward at least initially with generation unbundling only. Regardless, there is still no reason for a federal unbundling mandate. Each state that has addressed this issue has been able to make this determination without a federal mandate.

11. There is a wide divergence of opinion as to whether or not the Public Utility Holding Company Act of 1935 (PUHCA) should be modified or repealed. In view of the recent merger trend, PUHCA's protections have significance for all states, whether or not they traditionally have been served by a registered holding company.
 - a. Do you believe PUHCA is a significant impediment to competition, at the wholesale or retail level, or can "effective competition" be achieved regardless of whether Congress enacts changes to PUHCA?
 - b. Do you believe Congress should modify or repeal PUHCA, why, and under what, if any, conditions?
 - c. Should Congress enact legislation to modify the holding in Ohio Power v. FERC, 954 F.2d 779 (D.C. Cir. 1992)?

Answer: PUHCA's structural protections created an electric industry structure that made it possible for states to regulate electric utilities in a manner that was consistent with the public interest. Please see my attached testimony before the Senate Banking Committee in this regard. PUHCA, coupled with the Federal Power Act and state laws, create a web designed to prevent abuse of consumers and competitors by franchised monopoly providers abusing corporate form. PUHCA is as applicable in its structural protections as it was when first adopted sixty two years ago. SEC enforcement and administration of the Act, however, has been sorely lacking. PUHCA has served the public interest well and should not be discarded in the name of "leveling of the playing field." As we are now seeing in the telecommunications industry, the hope of competition seems to be yielding to greater consolidation. The FERC's rejection of the Primergy merger application appears to be the first sign that the application of traditional antitrust principles could be used to restrict market power expansion.

In light of the modifications that were made to PUHCA in 1992 and in 1996, we do not believe it necessary to amend PUHCA at this time. To the extent Congress wishes to address PUHCA at all at this time, it should be to overturn the perverse precedents created by the Ohio Power and Mississippi Power and Light decisions. If Congress does wish to make other changes to PUHCA, it should consider revocable waivers to the Integration Requirement and the Diversification ban only where each affected state has certified that there is effective retail competition in the affected retail service territories of each of the holding company's operating affiliates, and/ or the state has implemented divestiture for all of the holding companies' generating assets in order to mitigate potential market power abuses.